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SUBJECT: TURMOIL IN THE CYPRUS ENERGY SECTOR

11. (SBU) Summary: In the midst of a heated Presidential campaign, the Government of Cyprus (GOC) through the Ministry of Commerce (Energy Department) is preparing tender specifications for consulting and project management energy projects. The Government's insistence on constructing a temporary off-shore (floating) Liquefied Natural Gas (LNG) unit and the apparent involvement of the President's son and other political figures behind this push is politicizing the issue of how Cyprus will meet its energy generation and CO2 emission targets. The issue is further muddled by the desire of the current electricity monopoly (and its union) to limit increased competition. End Summary.

Tenders To Be Issued Soon

12. (U) According to information received from senior officials of the Ministry of Commerce, Energy Department and the Cyprus Energy Regulatory Authority (CERA), the GOC is currently preparing tender specifications for a Front-End Engineering Design (FEED) consulting tender. The preferred bidder for this project will draft the Terms of Reference for both an onshore (land-based) LNG unit as well as for a temporary offshore (floating) LNG unit at the Vasilikos Power Station area for utilization until the onshore facility is operational. The estimated release date of the tender documents is late October 2007. The GOC may also release a separate Consulting tender for an oil terminal FEED project and one for Natural Gas (NG) that will involve importing and storing both oil and NG. Project Management tenders will follow any Consulting tender released and awarded.

13. (U) There is a 45-day span from the date of tender release for the Consulting project until bid submissions are due. After that, the GOC will need approximately two to three months for evaluations and contract award. This timeframe runs up to the February Presidential elections. Because historically most major government contract award decisions have been questioned by the remaining bidders (usually the runner-up) through the Tenders Review Authority, an additional month or two for this process should be expected. As per the Director of Energy at the Ministry of Commerce, the GOC hopes to finalize the tender and hire a Consultant by March or April of 2008 - right after the Presidential elections.

14. (SBU) Experts here believe that under the most optimistic scenario, the GOC will have the tender documents for a land-based LNG unit ready for release by the end of 2008 with final delivery by 12013. This timeline is a significant lag from the initial GOC plan (formulated in 2003), which forecast an integrated LNG terminal and gas-fired turbine to be operational by 2009. Due to the need to increase energy generation capacity and meet EU-mandated reductions in CO2 emissions, the GOC says it will need a temporary (five-year) floating LNG unit although our contacts advise that such a unit

would probably not be available until 2011. There is also no indication of where the GOC would source its natural gas supply on a long-term basis given current tight market conditions.

A Gas Import Monopoly?

15. (SBU) A key question is whether importation of LNG will be an open market. One plan calls for the establishment of a new "Public Company of Natural Gas"(PCNG) which would have a 10-year monopoly on the supply of NG in the ROC under the "emerging market" provision of the relevant EC Directives (2003/55/EC, articles 22 and 28). The equity of PCNG would reportedly be divided between the GOC with 51 percent, the Electricity Authority of Cyprus (EAC - a quasi-governmental body owning most generating capacity and the transmission and distribution systems) with 39 percent, and private owners 10 percent. The arguments for state control is the need to negotiate government-to-government agreements for NG supply and, as an island, the lack of possible interconnects with other grids creating a natural monopoly.

Too Much Competition "Would Bankrupt Us"

16. (SBU) The General Manager of the EAC also told us that, since his organization is mandated to provide uninterrupted power throughout the country, it must make investments in peak-load capacity (such as the tenders mentioned in paragraphs 2-3) whose cost can only be covered if competition is limited for a certain number of years. His biggest competitive concern is the entry of independent power producers into the market, especially if they have access to "below market" gas. A Norwegian consortium, "Golar," has already received CERA approval to operate an offshore vessel that would receive LNG as fuel and generate up to 240MW of electricity. Total current installed capacity in Cyprus is around 1100MW. Golar is waiting to see if they have approval to import gas themselves before proceeding with their project. The EAC is furiously fighting this, arguing that Golar's Norwegian partners would provide "below market price" gas, rendering the EAC's new generating capacity uncompetitive. To further hinder Golar's ability to proceed, EAC is arguing that floating LNG terminals are untested technology not operating anywhere else in the world. The powerful EAC union has said that they are adamantly opposed to any floating LNG options. When asked why the unions are so opposed to this technology, the EAC official told us "because they know it would eventually bankrupt their company."

Politics

17. (SBU) Democratic Rally Party president, Nicos Anastasiades, held a press conference on October 3, 2007 claiming that the long delay in initiating a land-based LNG terminal was a deliberate ploy by President Papadopoulos or his associates in order to necessitate a floating LNG solution. The evidence Anastasiades presented to the press included information that involves President Papadopoulos's law firm and an attorney with that firm (son, Nicolas Papadopoulos) in SBM, the company that, according to Anastasiades, would have constructed and operated the unit. Anastasiades stated that George Lillikas, who was Minister of Commerce at the time, promised SBM he would look favorably at its bid. Note: Under Cypriot law, all major government / semi-government projects must go through a tendering procedure and contract awards are made after technical and financial evaluations are completed.

18. (SBU) Comment: In the current election campaign climate, accusations, purported copies of incriminating e-mails, and shouts of libel are common and may be expected to continue. Nerves are further frayed by the high stakes of the energy infrastructure game. Unfortunately, the short-term result may be further delay, until after the February elections, in proceeding with a variety of energy projects (including renewables with U.S. interests) that all parties agree are sorely needed to meet Cyprus' energy needs (growing 6-7 percent yearly)and reduce the nation's reliance on heavily polluting Heavy Fuel Oil (HFO) for electricity production.

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